DOCUMENT RESUME

ED 228 955 HE 016 124

TITLE	Student Financial Assistance and State Policy.
INSTITUTION	National Governors' Association, Washington, D.C.
SPONS AGENCY	National Commission on Student Financial Assistance, Washington, DC.
PUB DATE	Mar 83
NOTE	70p.
PUB TYPE	Reports - Evaluative/Feasibility (142) -- Tests/Evaluation Instruments (160)
EDRS PRICE	MF01/PC03 Plus Postage.
DESCRIPTORS	Access to Education; *Federal Aid; *Federal State Relationship; *Financial Policy; Financial Problems; Government Role; Low Income Groups; Policy Formation; Postsecondary Education; Private Colleges; *Public Policy; Retrenchment; School Taxes; State Colleges; *State Government; *Student Financial Aid; Tuition
IDENTIFIERS	Guaranteed Student Loan Program; *National Comm on Student Financial Assistance; Pell Grant Program

ABSTRACT

The interrelationships of state programs and federal student assistance are examined, based on a survey of 50 governors' offices. Attention is directed to: the impact on states and aid recipients of federal funding reductions; the current and longer-run outlook of the state fiscal position; and views of state officials responsible for carrying out gubernatorial policies on the appropriate roles of the federal government and state and local governments. Three major policy issues in higher education finance are also considered: how much higher education should cost; who should pay the bill, and what should be the division of responsibility between private and public institutions. Finally, the impact of federal policies on state decision making in higher education is examined. Conclusions include the following: neither the establishment nor expansion of the federal Guaranteed Student Loans nor grants for low-income students has had a significant effect on state decisions on support of higher education institutions and the tuition charged; and termination or major restriction of federal student assistance programs would have a major deleterious effect on private higher education institutions. Information on education tax expenditures of nine states and a sample questionnaire are appended. (SW)

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STUDENT FINANCIAL ASSISTANCE AND STATE POLICY

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For

The National Commission on Student Financial Assistance

March 1983

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INTRODUCTION

The National Governors' Association (NGA) and other groups of state officials have been studying the interaction of federal student assistance policies and state policies in higher education at the request of the National Commission on Student Financial Assistance (National Commission). NGA appreciates the National Commission's recognition that understanding of state perspectives and policy-making processes are important to its deliberations. Hopefully, it will take them into account in making its recommendations. The state perspective is important for two reasons: (1) state officials--who administer universities, provide money for and administer student aid programs of their own and administer federal programs--may have some valuable insights on the question of appropriate federal policy and (2) federal policy changes may trigger changes in state policy. These reinforce or tend to offset achievement of federal objectives. These state reactions could also cause federal programs to be more expensive or less expensive than would be estimated by a calculation that failed to take state reactions into account.

This report is based upon: (1) a partial review of the literature, (2) some discussions with persons who have been active in state higher education policy, (3) interviews with the governors' higher education advisors in 43 states and (4) reviews of coverage of student assistance in the governors' inaugural, state of the state and budget messages delivered in early 1983.

Readers should understand that this paper is a research product of NGA. The governors have adopted explicit procedures for the adoption of

policy which, in substance, concentrate policy actions in two annual meetings. In unusual circumstances, the Executive Committee of the Association is also authorized to take policy positions. Research reports, such as this one, do not follow NGA's process for the approval of policy. Therefore, the observations in this report are not a policy position of NGA.

The current policy position of NGA regarding higher education states:

1. The federal role in post-secondary education is limited to those areas that are in the national interest. They include:

   - o Guaranteeing Access for individuals to attend a post-secondary education institution without regard to their family income, race, national origin, sex or handicapping conditions, through student financial assistant and other means.

   - o Preparing The Work Force by funding programs which address state-identified worker shortages and assure an adequate labor supply in areas requiring special technical and advanced training.

   - o Supporting Research and Development at post-secondary education institutions and associated research centers.

2. Nationally directed research, demonstration, data collection and innovation (with special emphasis in the next ten years on technologies) should be maintained and recognized as a set of core responsibilities of the federal government in education.

EXECUTIVE SUMMARY

This report is designed both to acquaint the Commission with information about the interrelationships of state programs and federal student assistance as seen from a gubernatorial perspective. The report first discusses four factors that are necessary for understanding the environment in which state higher education policy is being made: (1) the impact on states and benefit recipients of reductions in federal funding generally, (2) the current fiscal position of states, (3) the longer run outlook for state fiscal position and (4) views of state officials responsible for carrying out gubernatorial policies on the appropriate roles of the federal government and state and local governments.

The paper discusses the three major policy issues in higher education finance: (1) how much should higher education cost, (2) who should pay the bill and (3) what should be the division of responsibility between private and public institutions. It then examines the impact of federal policies on state decision making in higher education from two perspectives. The first is analytic, considering what responses to federal policy change one might expect from state officials based upon the economics and some of the politics of the situation. The second is behavioral, focusing upon the climate in which state higher education decisions are made. These two approaches suggest somewhat different conclusions on the question of state responses to federal policy changes.

The resources available to NGA and the division of labor established by

the Commission for the various state groups did not permit as much comprehensive research on state interactions with federal policy as NGA would have liked, so the report's conclusions should be considered in this light. However, based upon the evidence available, the report concludes:

(1) Neither the establishment nor expansion of the federal Guaranteed Student Loans (GSL) nor grants for low income students (BEOGs and Pell Grants plus certain campus-based smaller programs) has had a significant effect on state decisions on support of higher education institutions and the tuition charged by those institutions. The alternatives under consideration for modification of these programs, either by expansion or restriction of the federal commitment, are unlikely to have a significant effect on either state higher education spending or tuition decisions.

(2) The effect of these programs has been to increase the access of lower income persons to higher education provided by private and state-supported institutions. Federal policy changes will neither be reinforced nor negated by state decisions on funding of educational institutions or tuition--their impact will be felt by the students themselves.

(3) The federal State Student Incentive Grants (SSIG) have had mixed effects. They stimulated, and today stimulate, state programs in some states that would otherwise not have state student

assistance programs over and above those provided by state public higher educational institutions. In other states, the federal program encourages states to do what they already would be doing without federal involvement and, in some major cases, what they were doing before the federal program began. At a minimum, changes in this program are likely to be reflected, more or less dollar for dollar, in state scholarship assistance.

(4) Termination or major restriction of federal student assistance programs would have a major deleterious effect on private higher educational institutions, in terms of their viability, quality and accessibility to low income students. Deterioration in these dimensions would increase pressures on states for action to overcome these problems, but the pattern of state action would be uneven nationally, and would not be enough to offset the federal impacts.

FACT SUMMARY

Introduction. This is the report of a survey conducted by the National Governors' Association (NGA) for the National Commission on Student Financial Assistance. This work is part of the process of developing an NGA report on the interaction of federal and state higher education policies. The choice of using a 50 state survey of governors' offices as distinct from using other methodologies was basically made by the Commission based upon a desire to have parallel interviews in state higher education executive offices, state legislatures and governors' offices.

A technical elements section describes the survey methodology and discusses the usefulness of the results for policy formulation. Readers are cautioned not to use raw survey results without first understanding the caveats in the technical elements. A copy of the survey instrument is attached. Questions are not repeated in the text, only referenced by question number.

Effect of Federal Student Aid on State Higher Education Spending (Questions 1 & 2). When asked about the effect of federal student aid on state student aid spending respondents said the federal aid caused:

More state spending	12
Less state spending	7
About the same state spending	23
Don't Know	1
TOTAL	43

In the cases where more spending was said to result from federal assistance, the matching provisions of the State Student Incentive Grants (SSIG) were most often cited as the cause. Other causes cited were the demonstration effect of the federal programs in calling attention to needs for student assistance and cutbacks in previous federal student assistance efforts.

In the cases where less state spending was said to result from federal aid, the most commonly cited effect was displacement, although the term was not used. The effect described was one where a state might have acted to meet certain needs had the federal government not acted to meet those same needs.

In the majority of cases, respondents did not see any effect of the federal spending on state spending. Their logic was typically that the state decision-making process for the student aid was basically independent of the federal decision-making process and its results.

Federal Impact on Form of State Assistance. Respondents were asked whether federal programs had caused their state to emphasize grants, loans, or any other form of state assistance and to volunteer reasons for any such effects. Some respondents did not answer the question and several gave multiple responses. The results are:

Grants	7
Loans	20
No Effect	13

Those indicating that the federal effect had been to encourage grants most often cited the SSIG program which clearly caused and causes

some states to make expenditures for grants that they would not otherwise make. Those indicating loans typically cited the Guaranteed Student Loan (GSL) program which states typically participate in administering. Those citing no effect were typically in states that are not particularly active in student assistance programs. Officals of three states volunteered that federal programs had encouraged their state to provide student assistance through work-study programs.

Federal Impact on Institutional Support. The question on federal impact on state institutional support found officials of 37 states willing to speculate on the subject. Of these about 60 percent (22) indicated that there had been little or no effect. Eleven felt that the federal effect had been to increase state institutional support and four believed that state support was reduced because of federal student aid. Some of those indicating that federal student aid caused more state institutional support reasoned through the following logic: (1) federal student aid has improved access which has created higher enrollment in public institutions, (2) state costs for institutional support increase with enrollment, therefore (3) federal assistance has caused states to spend more for institutional support.

Federal Impact on Private Education (Question 6). Federal aid was seen as having little or no effect on state support of private higher educational institutions by 63 percent (24) of those expressing a view on this subject (38). Of those reporting an effect, most (12) saw the effect as being more state aid rather than less (2).

Federal Impact on Tuition Tax Credits (Question 7). Most states do not have tuition tax credits, so it is not surprising that 35 out of the 38 respondents speculating on the effect of federal student aid policies on tuition tax credit policies reported no effect.

Federal Effect on Policies Toward Two-Year Institutions (Questions 8 & 9). Overwhelming majorities of respondents agreed that federal student aid policies had had no effect on state support of two-year institutions relative to four-year institutions (34 of 42) and on forming new two-year institutions (36 of 42). Six respondents in each case indicated that federal aid had encouraged two-year institutions, generally based upon reasoning that federal student aid increased effective demand for the services of such institutions.

Other Federal Effects (Question 10). The other effects of federal aid most volunteered by respondents were:

1. Increased access to higher education,
2. Increased enrollment resulting from access and
3. Effects of unstable federal student aid policies.

Student Aid in this Legislative Session (Questions 11 & 12). The responses indicate that the legislature has, or has had, before it, proposals to increase or decrease student aid substantially in 28 of 43 responding states and that a governor's proposal was involved in 18 of the 28 cases where proposals were under consideration. These numbers should not

be considered a significant indication of trends as respondents varied in whether or not they thought various proposals were serious enough to mention and in their implicit definitions of significance when dealing with budget changes.

In six of the states proposals relating to math and science education were under consideration. These are typically either assistance for summer programs for existing teachers or loans which are forgiven if the borrower teaches math or science for a stipulated period of time. Significant changes in assistance to private institutions and/or students and expanded work study programs were mentioned in several states.

Sensitivity to Federal Policy Changes (Questions 13-17). According to the responses, if the federal SSIG appropriation were held constant and the state matching share raised, 26 of 34 responding states would have their appropriations unaffected by the federal policy change. This is a logical response for a state that is already in an "overmatch" situation. In seven of the 37, the respondent speculated that state spending would increase--a logical outcome for any state following a policy of doing what is required to obtain the federal funds and no more. One respondent indicated a decrease in state spending, suggesting that at some point the match could become so expensive that a state would drop out of the program.

Confronted with a hypothesis of reduced federal SSIG funding with no change in match nearly 80 percent (30) of the respondents (38) indicated that state funding would remain about the same. This suggests in most states such a federal cut would, in effect, be passed through to the

students. Officials of six states indicated there would be an increase in state spending, though not necessarily enough to offset 100 percent of the federal reduction. Officials of two states indicated they would reduce their state funding under this circumstance.

Twenty-nine of those interviewed agreed to speculate on what their states would do if confronted by a matching requirement in all federal student assistance programs. Nineteen, or about two-thirds, indicated that state funding would remain the same. In those cases, the effect of the federal policy change would be to redirect some state support from existing state programs into matching the federal funds. Six respondents indicated this federal policy change would result in increasing state student assistance spending and four indicated state spending would be reduced.

When asked to specify federal policy changes that would cause states to spend more on student aid, 36 persons took a stab at the question. Officials of eight states indicated there were no such federal policy changes. These eight states are among those with the most significant fiscal problems in the nation. Most of the remaining respondents indicated that some attempt would be made to increase state spending to offset some of the impact of the federal cut. The officials being interviewed are persons specializing in higher education who would know reasonably well whether attempts would be made to sell governors and legislatures on compensating for federal program cuts in student aid. However, they are not in a good position to speculate on the outcome of such attempts, so many simply indicated there would be some pressures to offset the impacts of federal cuts. Officials of a few states, generally those with lesser fiscal

problems, indicated specific federal program changes that would probably result in increased state funding by their state. Included were dropping the SSIG program, tight means tests for GSLs and state matching requirements on all programs.

If there were more state spending on student aid, it would not necessarily equate to more state spending on higher education. Of 33 respondents willing to speculate on this, exactly two-thirds said higher student aid would mean a reduction in funding for other higher education programs.

Suggestions on Federal Student Aid (Question 18). Thirty-three of the 43 respondents accepted the opportunity to volunteer suggestions on federal student aid policy. Eight of these comments concerned only one subject--stability in federal policy. It seems clear that having federal student aid policy continuously "up in the air" has caused difficulty for state officials as well as students.

Many of the other comments were generally supportive of current federal programs designed to improve access to higher education by lower income students. Other volunteered comments did not follow any particular pattern. The respondent from a state with particularly high living costs believes that federal student aid programs should reflect cost of living differentials. Another respondent objected to tying federal student aid to Selective Service registration. Another suggested that the federal government concentrate on its base student aid programs first and deal with specialized programs only as a supplement to the base. Another suggested emphasizing loan programs at the federal level.

Yet another wanted better coordination at the federal level of student loan programs of various agencies (e.g., HHS, VA, Department of Education) that provide student assistance. One suggested that the unemployment insurance rules create a disincentive for work study programs.

Suggestions were mixed on federal emphasis on merit versus need. Some wanted more consideration of merit; others suggested the federal programs should concentrate on need. Several state officials suggested that the federal government improve its procedures to avoid delinquencies. Someone suggested that the federal government waive repayment of student loans for those persons who accept and hold jobs targeted as having national value (e.g., math and science teaching, rural medical care).

TECHNICAL ELEMENTS

Methodology. The phone survey was preceded by a letter from NGA to persons in each state who had been designated as the governor's education coordinator in connection with another NGA project. This mailing included a copy of the questions to be asked in phone interviews (attached). Calls were placed in March of 1983 to the persons on the list. In some of the cases, the governors' staff members involved indicated that the questions could most knowledgeably be answered somewhere else within the state. These referral suggestions were accepted with the result that some of the persons interviewed were in state budget offices and a few are associated with higher education coordinating boards or student aid agencies. However, the bulk of the responses are from governors' offices.

Caveats. There are some substantial caveats associated with uses of the responses of this survey. Some of these relate to the persons interviewed. Governors' staff members tend to turn over rapidly even when the governors do not change and typically all turn over when a new governor is elected. As a result, some of the persons answering the questions have quite limited knowledge of the federal programs involved and the history of their effects on state policy. In addition, the questions themselves require some skillful mental work by respondents.

Questions one through ten all take the form of comparing the actual situation in the states today with what would have been in the absence of federal aid. Answers to these questions imply that the respondent has thought through completely the policy responses of the larger number of relevant policy makers to a different federal aid situation and how disputes among them would have been resolved. For example, it is possible that the presence of federal aid made state institutions less likely to provide institutional aid and that smaller federal programs would have resulted in greater use of programs such as fee waivers. To detect this, however, the respondents would have had to think through institutional positions on student aid, translate those into demands made in the budget process, and predict how those demands would be met.

Questions 11 and 12 call for information within the knowledge of respondents.

Questons 13-17 involve speculation about future events given two fact situations (current policy and a changed policy) and are based upon the respondent's ability to predict the positions of the various persons who influence decisions and how cross pressures will result in a politically determined outcome. This is inherently difficult.

No attempt was made to define quantitatively such concepts as significant increases in programs, e.g., the difference between leaving funding "about the same" and decreasing it, etc.

Thus the survey results should be viewed with considerable caution. They normally should be presented as they are (two-thirds of those interviewed in a survey of governors' offices said...) and not themselves as conclusions (two-thirds of the states would...).

THE OVERALL STATE POLICY PERSPECTIVE

The major state decisions on student assistance are being, and will be, made in an overall context with four important elements: (1) the impact of general federal assistance reductions, (2) the short term fiscal condition of the states, (3) the longer term fiscal outlook for the states and (4) perceptions of state officials about appropriate state and federal roles.

Impact of Federal Assistance Reductions

The federal government has begun to shrink its role in supporting activities of state and local governments. Estimated federal grant outlays for FY 1983 are lower than actual outlays in FY 1981 and the President's budget projections envision growth in grants as slower than the rate of inflation. It is generally believed that real (inflation-adjusted) federal grants to state and local government will decline in the future.

The governors, in the 1983 NGA Winter Meeting February 27-March 1, indicated major concerns over the impact of federal deficits on states and adopted a resolution indicating that non-defense discretionary spending (which includes many grant programs) should grow slower than the rate of inflation from FY 1984 to FY 1988. The governors indicated that "means-tested and other critical entitlement programs" (a category that includes Guaranteed Student Loans) should have "almost full funding."

This stress on maintaining federal funding for means-tested programs is consistent with the views of the governors on appropriate state and federal roles, as discussed below.

Enough returns are now in on the effects of 1981 and 1982 reductions to support some general statements on how states, with exceptions, are handling both absolute reductions in federal grant programs and the continued erosion of grant purchasing power resulting from freezes of various kinds. It is clear that states are acting to mitigate the adverse impacts of federal funding changes. Some of these actions are nearly automatic. Stricter eligibility standards in some programs can throw recipients into state general assistance programs, for example. Other mitigation has taken place in state funding for some relatively low cost activities. Still other mitigation has taken place through state use of the increased flexibility accorded state officials in the block grant programs.

However, state attempts to mitigate damages from federal program reductions have fallen short of what would be required for state governments to provide the same funding formerly provided by the federal government. Thus, any changes in federal student assistance policy will find the states in a circumstance where they are under substantial pressures to deal with past and new additional cuts in programs outside higher education. This situation affects higher education funding by adding to the general "tightness" of state fiscal conditions.

Short Term Financial Problems

The current state fiscal situation was recently characterized in a joint publication of NGA and the National Conference of State Legislatures as "extremely bleak." Indicators of problems abound: balances are low and sometimes negative; states which almost never borrow short term are

borrowing; total state employment is decreasing; revenues are down from estimates and estimates are down from earlier estimates; many states have frozen hiring, cancelled equipment purchases and taken similar actions. Five legislatures met in special session in late 1982 to enact tax increases. At least half the state legislatures will be considering major tax increases in 1983.

The basic cause of this situation is the recession, but there will be a hangover even after the recession is over. State officials will try to restore their balances and many, burned by the 1981-83 experience, may try to siphon off some current revenues for "rainy day" funds. Deferred maintenance will take its toll as will legitimate claims of employees for "catch up" pay increases to make up for periods when pay was frozen.

The result is that, in the short term, state officials are preoccupied by fiscal problems and are busy considering what to cut. As a result, they are unlikely to initiate new programs or replace federal funding for major federal programs such as student assistance in their current fiscal circumstances.

Fiscal Conditions, Long Run

Absent recession, state tax systems generally provide approximately the revenues required to continue existing state services including matching inflation in the large percentage of state budgets sent to local governments for roads, schools and other purposes. However, this general conclusion is not applicable to each and every state as some state revenue structures are more elastic (responsive to personal income changes) than others.

The key longer run fiscal question is whether state decision makers will be willing to do more than continue existing services, and if so, what they will chose to finance. Statements about this outcome are speculative of course. Trends since the early 1970's suggest that the state government share of gross national product (excluding state activities financed with federal funds) has been dropping. Trends also indicate that state governments are picking up a higher share of state-local costs, a trend particularly evident in the financing of elementary and secondary education. If continued, these trends would suggest no massive expansion of state governments into new programs and that replacing local tax sources in financing local government will continue to enjoy a high priority.

One indication of what state officials will do in the future is what they are saying today about their attitudes on expansion of state government spending and taxing. While there are exceptions, and no one has a precise count, the pronounced policies of state officials today appear significantly less supportive of expanded government roles and spending than in at least a decade. This would suggest that there are limits on the likelihood that states will expand their funding to assume responsibility for major program adjustments of the federal government.

Views on Appropriate State and Federal Roles

Over the past two years, governors have paid considerable attention to the appropriate roles for the federal government and state and local governments. Several governors have made proposals of their own on this

subject and the governors collectively have addressed it in their discussions with the President and his staff on "New Federalism" proposals. The governors (and state legislators) have taken positions that can be summarized by distinguishing between basic state and local services and major programs involving income redistribution.

The governors have shown considerable willingness, assuming satisfactory transition arrangements, to accept state and local financial responsibility for what might be called basic services. These services were provided by state and local governments before the federal government became involved with them. They have never been explicitly listed by the governors, but have been illustrated (e.g., education, transportation). They presumably consist of such things as fire protection, police protection, local schools, libraries, water supply and sewage (excepting federally mandated sewage treatment plant construction), parks and recreation, mental health and institutional support for higher education.

On the other hand, governors and legislatures have consistently opposed shifting to the state programs which involve large quantities of means-tested assistance--specifically food stamps, Medicaid and Aid to Families with Dependent Children (welfare). Other means-tested programs (e.g., subsidized housing, Pell Grants, Guaranteed Student Loans and certain child nutrition programs) have received less attention in the "New Federalism" discussions but have characteristics akin to welfare and Medicaid. The importance of a federal role in providing access in higher education is explicitly recognized in the NGA policy position quoted in the introduction to this report.

One key reason why state elected officials recognize their own limits in accepting responsibility for means-tested programs is that their cost is determined by national circumstances beyond the control of those officials. A recession strikes and the number of persons who pass means tests in Michigan grows rapidly. Farm prices drop and Nebraska revenues drop and the number of persons who pass means tests rises simultaneously. This concern extends to the states now having the highest fiscal capacity and lower concentrations of target populations. The oil producing states have recently seen oil drilling drop by 50 percent; oil shale goes from boom to bust; and copper mines close. The state with the currently highest fiscal capacity (Alaska) expects the bulk of its oil resources, almost its sole state revenue source, to be exhausted in a decade.

Not only are state tax revenues and costs of means-tested programs subject to national economic phenomena and national policy in the short run, the need for means-tested programs is a function of longer term trends. A significant part of the poverty population in the Southeast results from persons made surplus by the mechanization of argriculture. Much of the poverty in the Southwest can be tied to migration. New refugees are part of the poverty population in several states. No governor can be quite sure where growth in poverty populations will occur. Perhaps in the Midwest as basic industries lose out? Perhaps in the Southwest if it outruns its water supply? Because of uncertainties over which states might gain and lose from using national taxes to support means-tested programs, governors from states that currently pay more national taxes than they get in spending have been comfortable in supporting extension of federal financial responsibility for these programs.

Accepting state responsibilty for major means-tested programs subjects individual states to both the expenditure and the revenue consequences of such uncontrollable changes in the future. In addition, it would create substantial inequities in the present. The greatest needs for means-tested expenditures tend to coincide with the least capacity of state and local governments to raise money. Mississippi, for example, leads the nation in the percentage of persons in poverty (1979 income) with a 24.5 percent poverty rate versus 12.5 percent nationally and trails the nation in state and local fiscal capacity. As measured by the Advisory Commission on Intergovernmental Relations' representative tax system, Mississippi's fiscal capacity is 69 percent of the national average.

Thus, the reluctance of state elected officials to assume responsibility for means-tested entitlement programs is based upon disparities between state capacity to handle such programs and concern over the impact of uncontrollable national phenomena on state costs. This concern is an important background factor to consider in relation to proposals that would assume state acceptance of responsibility for the current clientele of Pell Grants, Guaranteed Student Loans or even SSIG.

MAJOR POLICY QUESTIONS

In overall perspective there are three fundamental financial questions in higher education: (1) how much will be spent on higher education, (2) where will the funds come from and (3) what will be the relative role of private and public institutions.

What Education Costs

Broadly speaking, the national costs of higher education are a function of (1) the number of students and (2) the services provided to those students, including (a) the mix of services provided to students (e.g., how much medical training relative to theater), (b) the "technology" used to provide services in each area (e.g., types of faculty training, equipment, course loads, class sizes, etc.) considered appropriate and (c) the prices paid to factor inputs such as faculty salaries.

In the world before state and federal assistance to students and private institutions, the decision about the factors driving the cost of higher education were made in a marketplace with few constraints. The constraints that did exist (e.g., accreditation) were effective only because they were respected in the marketplace. Now, however, state and federal officials are paying a significant percentage of the costs of the higher education system as a whole. To a significant degree the determination of what education will cost in a public institution is a function of what state officials are willing to spend and what those officials will let the institutions charge students.

From a federal perspective, one important question is how total costs of higher eudcation will be affected by federal policy. The effect of federal grant support of institutions is, for example, cost increasing. That is, when the federal government provides institutional support the intended result is higher institutional spending than would otherwise be the case.

Unlike grants to institutions, federal student aid is not deliberately administered to increase costs and outputs of educational institutions. Obviously, however, federal spending on student aid does make some real resource injections into higher education. On the federal side these real resources can be measured as the sum of grants, tax expenditures and the subsidy element of the loan programs. From a state/local perspective, the maximum federal contribution of resources is the above minus the added state/local costs (e.g., administration) which appear to be directly caused by the federal involvement.

A key question is what effect federal resources have when channelled through various vehicles into the higher educational system. In broad terms, the possibilities are:

(1) Federal resources increase total system costs and, hopefully, system outputs,

(2) Federal resources do not increase total system costs but alter who pays those costs by:

    (a) Substituting for resources that otherwise would be provided by state government,

    (b) Substituting for resources that otherwise would be provided by students, including those who pay their bills or

(c) Substituting for resources that otherwise would come from private sector sources other than students (e.g., donations).

Who Pays the Cost of Education

A second critical question is how responsibility is divided in paying education costs. The significant choices are:

(1) Students, either on a current basis or through loans,

(2) State and local (mostly state) governments and

(3) The federal government.

As used in this discussion, the "student" refers to the student and all his or her non-governmental financial backers. Other potential payors (private contributions, endowment income, privately sponsored scholarships) are probably not large enough to be significant for public higher education institutions.

It is possible to stand back from the hurly-burly of state and federal decision-making to take an academic approach to the question of who pays. For an economist the applicable logic is reasonably clear. Most higher education has some benefits that are captured by the student--higher earning power in the future, enjoyment in going to school, future ability to be effective in social life, athletics or whatever. There are also benefits to society, although experts do not agree on how to quantify them. There are also costs, the costs of providing the education, the costs of maintaining the student's health and providing room and board and the costs of student opportunities forgone including lost wages and working experience. Conceptually, what the student should pay should be related to the benefits

which the student is expected to receive. If the student gets 80 percent of the benefits then perhaps the student should pay 80 percent of the cost.

However, this is by no means the only view expressed on this point in state capitols. Another view holds that the key value to be sought is access to higher educational opportunity. In this view, the appropriate policy is the one which imposes the least possible cost on student. Imposing costs on students, over and above the opportunities foregone, is perceived to discourage consumption of higher education, although the magnitude of the effect is disputed.

The decisions made by state officials have important implications for the costs of federal policies. Current federal higher education policy provides almost no guaranteed support for suppliers (educational institutions) but considerable support for the customers (students). The maximum cost of such a policy is set by what percentage of total cost is charged to the students. In the case of private institutions, this percentage inherently approaches 100 percent, but for state institutions it does not. State decisions on tuition levels will have impacts on the costs of federal student aid programs.

Private and Public Providers

While the impact of public policies on private higher education is debated, the primary arguments concern the magnitude and desirability of effects, not the direction of impact. The growth of public institutions has affected growth of private ones. Had states not put the resources they did into their own institutions, all education would be private. The result would be more students in private institutions than there are today, but

less students in total than in higher education today because of higher costs and less geographic access. Second, in particular instances, the expansion of state-supported higher education has demonstrably damaged the ability of private institutions to provide the quality of education they had been accustomed to providing to the share of the market they once served.

It can be argued that these results are undermining the foundations of private higher education and that they eventually will destroy all but the very strongest of the private institutions, that a strong private sector is essential for one reason or another, and thus that the policies should be changed or their deleterious effects mitigated in some fashion or another. Conversely, it can be argued that the vital question is access and excellence and that if states provide these in higher education, no consequence in the private sector can be too severe.

While the philosophical questions in the private-public debate are difficult to resolve, the specific options for action to enhance the role of the private sector are easily understood. If enhancing the private role is the desired outcome, public policies must increase the attractiveness of private institutions relative to public ones. This could be done by making private institutions more attractive, public institutions less attractive or both. Public institutions can be made less attractive by deliberately reducing their quality (not really an option) or increasing the costs of attending them. Private institutions can be made more attractive by giving them public money directly or reducing the effective student cost of attendance by public scholarship and loan programs.

ANALYTIC AND BEHAVIORAL PERSPECTIVES ON STATE RESPONSES TO FEDERAL POLICY

There are two basic ways to consider state responses to federal student aid policies. The first is analytic; the second, behavioral.

Analytic Approaches

An analytic approach begins with the assumption that the state decision makers have roughly the same facts as the analyst and that the state decision-making process produces results that coincide with an analyst's view of rational behavior. These are the easiest kinds of analyses because all the analyst has to do is ask what he or she would do if a state official.

For this type of analysis, the relevant factor is "the state" which gets viewed anthropromorphically as having a mind of its own. This is a very misleading view, as will be noted in the discussion of behavioral approaches.

Before we introduce a federal policy change, the "state" will have set its policies on how much of that spending will be financed by students, and how issues of private and public higher education should be handled. This means there will be a "solution in place" regarding appropriation levels, tuition levels, aid to privates and state student aid spending and policies. This solution will presumably reflect circumstances unique to each state, including the wealth of students and institutions, the preferences of the voters, the fiscal capacity of the state and whatever else is relevant to the decisions involved.

It is possible, but unlikely, that a federal policy change will change the state's view of the optimality of its solution in place. For example, a federal decision to expand institutional aid will not automatically produce state concurance that the cost of education should go up, nor would a decision to make more loans to students automatically cause the state to decide that students should pay more or less. However, the federal action may have the effect of making it possible for the state to shift some costs to the federal government. From a state perspective, this is desirable because doing so spreads the costs over the entire nation while retaining the benefits in the state. The resources thus freed could be used for any number of popular steps as either tax cuts, new spending or both.

From an analytic perspective, the Pell Grants defray a significant percentage of student costs for a relatively small proportion of the students. Because the ceiling of Pell Grants has the effect of providing major assistance to students in high tuition private institutions, increases in tuition at state institutions would be offset for participating students by higher Pell Grants. However, it would appear that not all of any tuition increase would be offset. If the effective Pell Grant ceiling for public students is one half of educational cost then only one half of the tuition increase would be offset. Other things being equal, one would expect the existence of Pell Grants to encourage higher tuition at state institutions. The extent of the impact would depend upon the percentage of total tuition paid by Pell Grant holders and how comfortable state decision makers would be in either absorbing the other half of the tuition costs increase or assuming the student could absorb it. When these factors are considered,

the overall impact of the existence of Pell Grants on the tuition decision would appear to be minor.

Analytically, the availability of GSL would also appear to cushion the blow of tuition increases on the student and parents. However, the penetration of public sector student populations at the undergraduate level with student loans is not high. Not supprisingly, the greatest GSL market penetration is in graduate schools and private institutions. In addition, the GSL subsidy is nowhere near 100 percent of tuition. From a student perspective, how much subsidy is involved depends upon alternative interest rates and sources of funds other than borrowing. But in terms of state tuition policy, GSLs defray only a portion of increased student costs from tuition increases and then for only loans to a relatively small proportion of the students.

Smaller "campus based" programs also reach a small percentage of the student body and therefore have only minor, if any, impact upon state decisions.

Thus, analytically one would expect the presence of the federal programs to lend some weight to arguments for increasing state tuition. However, because of incomplete market penetration of the federal programs, tuition increases would affect a significant number of low income students not receiving assistance (e.g., part time students) and a large number of the middle income persons who are the subject of considerable concern when tuition policies are set.

Behavioral Analysis

The previous discussion describes a theoretical approach to potential reactions of state policy makers to federal student assistance policy. These are not necessarily the factors that are actually taken into account by state decision makers. This section explores the differences.

The three basic policy choices listed above (how much is spent in the public, who pays it, and what happens with public support of the private intitutions) represent three of about 20-30 major decisions that tend to be decided as part of a state's budget process for the same reasons that most major federal policy decisions involving money get decided in the federal budget process.

Power relationships vary from state to state and over time in the same state. However, there are a number of higher education decisions that a legislature and governor can, and sometimes do, effectively leave in the hands of the higher education community lead by a higher education coordinating board or equivalent. Those decisions include the logic for allocation of funds among institutions, the decisions on supporting new programs (within a higher education bottom line) and discontinuing old ones, etc. The higher education community, particularly if it can put up a common front, may have effective control over these matters even if it lacks any formal delegation of power.

However, elected officials cannot give to higher education officials the power to decide the total state funds going into higher education any more than they could let the comparable decision for welfare be made by welfare officials.

Thus, the decision on the overall size of the public higher education pot is made centrally. The private-public balance decision tends to be made centrally also as private institutions find it difficult to believe that a single coordinating board can carry out dual roles of overseeing a total private-public set of institutions and at the same time have clear responsibility for the health of the public institutions alone. The stronger private institutions tend to have many substantial friends in high places (including alumni in legislatures) who are not inclined to delegate decisions on dealing with private institutions to others. Finally, the tuition decision is typically made (or contolled indirectly) in the legislature as well. First, tuition is considered a matter of extreme political sensitivity. Second, if universities were allowed to set tuition at any level they wanted the decision on how much to spend would effectively be taken out of the hands of elected officials. University officials could consider their appropriation as a contribution, set total spending and spend whatever they believe to be necessary by setting tuition to match the difference between their desired total spending and revenues from other sources.

For federal education assistance to have any effect on state legislatures and governors directly (as distinct from having an effect through advisors such as state higher education coordinating agencies), it would be necessary for those oficials to know what federal policy is.

Inteviews by both NGA and the National Conference of State Legislatures suggest that there is very little knowledge in governors' offices and the legislature about specific federal programs such as Pell Grants. This fact is itself relevant as public officials acquire knowledge that they think they need to make their decisions. Their lack of specific knowledge of federal student aid programs suggest that these officials do not feel they need to know about federal programs to make their state decisions. This evidence is consistent with two hypotheses: (1) these decision makers rely on the recommendations of others (e.g., state higher education coordinating boards) and these others have this knowledge or (2) the knowledge is viewed as irrelevant. We reject the other possible inference (that the knowledge is relevant and the officials are not capable of acquiring or retaining it) because of the ability of the same types of officials to recite federal program information in great detail where it is key to state decisions as is the case with Medicaid and highway programs.

State higher education agencies and budget offices did their work on state FY 1984 higher education budgets in the summer and fall of 1982. For them to take federal policies into account in preparing the budget for FY 1984 (School Year 1983-84) they would have to be able to predict federal policies applicable to that year. This would not have been an easy task in mid-1982 as the Congress was then debating major student aid issues affecting FY 1983 and the President had not yet formulated his recommendations for FY 1984. State officals constantly complain about uncertainty in federal programs. Their complaint typically is that they cannot tailor their actions to federal policy because federal policy is

undecided. This criticism would seem to be perpetually "up in the air." The NGA questions to governors' office education advisors included an open-ended opportunity to make suggestions for improving federal student aid. Reducing uncertainty was one of the major points made by persons volunteering suggestions.

For example, as legislatures consider FY 1984 budgets in early 1983 there is a limit to what they could know about federal policies likely to be in effect for the fall of 1983 and subsequent years. They could know that the student aid decision was a cliffhanger last year. They could know that there is a special commission on student aid that has not made recommendations yet. They could know that the President has made proposals which would have massive effects on federal student aid. They could know that some Members of Congress are likely to resist these changes. They could know that Congress is under considerable pressure to cut spending. Finally, they could know that sometimes the President wins with Congress and sometimes he does not. Given this knowledge, which is all anyone has, state legislators in all likelihood will not base their FY 1984 higher education decisions on federal student aid policy.

Thus, with present policies unknown and policies for the relevant future unknown and unpredictable, it would not be surprising to find that in practice state officials do not give major weight to federal policies in deciding state policies. This conclusion is also suggested by the way in which state higher education decisions are made. In states, the budget process has a logic of its own which affects how these decisions are made.

The state budgeting process is normally incremental. That is, with exceptions particularly for new governors, it is not normal for state officials to start their budget consideration from a black slate or from levels which a budget director or comparable person might want to recommend. Instead, the consideration of the future starts with the present. States have counterparts to the federal concepts of baseline or current services. Conceptually, this is what the state would spend if it continued present policies adjusting only for workload (e.g., changes in number of welfare recipients) and for changes in uncontrollable prices.

The details of the process vary, but typically budgets will be considered around some sort of a baseline or norm which varies with the fiscal conditions of the state and the predilections of the persons to whom the budget submissions are made. In a normal year, budget consideration in the executive branch would typically examine a current service level, one or more levels above it and reductions in it. In effect, this means the executive is looking at proposals for adds to and cuts from the current budget base, not at the whole budget. Ambitious attempts to change this approach (e.g., zero base budgeting) have quickly reverted to it.

It is hard for federal officials who deal with the federal grant programs to understand the difference in volatility between state (and local) budgeting and federal budgeting. In federal programs in fields such as higher education, the federal presence is overlaid on a basic system of service maintained and paid for by state and local governments. In such a system, it is possible to consider emphasis on math and science programs while ending support for professional education, completely eliminating a public services jobs program while starting a whole new manpower program

etc. This policy volatility would probably not be tolerated by the public if it affected them directly. However, what the public sees are schools, universities, roads and other public services maintained by a relatively stable flow of state and local funding. To understand state budgeting, federal officials might imagine a federal budget composed entirely of the same kinds of functions. This would be like having a budget of the National Park Service, the Geological Survey, the Weather Service, the FAA and the Bureau of Prisons, perhaps also including stable grant programs such as Community Development Block Grants and Social Service Block Grants.

The budget process in state legislatures is often more incrementally oriented than even that of the executive. Power on the key committees that control money is normally held by relatively senior members who are looking at the pattern of current spending as the reflection of decisions they made in their last session. Their instinct in making good use of the review time they have available is to focus on changes in that pattern, particularly any proposals to spend more money or make cuts.

A strong focus on the increments tends to focus attention on change and comparative change rather than the base. If the overall approach is to maintain current service levels without tax increase, this approach will tend to be reflected in detail (including in higher education). For example, when states go through funding reductions, hiring freezes and cutbacks in purchases, the austerity tends to be spread around all agencies. In a more normal year, the overall thrust of typical state budgets is

current services, state-controlled price increases (state employee pay, higher education pay, increase in elementary and secondary support, welfare payment levels) roughly at the rate of inflation plus workload adjustments such as those now being made to put more money into the corrections function. When a governor and legislature find it appropriate to propose significant new tax increases, they will normally ensure that the base of support will be broad because new purchasing power will affect school teachers, state employees, the university system, etc. This is not to say that there never have been massive changes in state funding patterns or that small differences in increments repeated year-after-year do not ultimately result in major policy change, but that the entire state process has the elements of stability characteristic of federal review of the Park Service which is very different from federal review of education programs.

Thus, from a behavioral perspective, one would expect to find that state higher education funding decisions are little touched by federal student aid decisions. Instead, one would expect to find a pattern of consistency between decisions affecting higher education funding and decisions affecting other state funding. On a national basis the patterns probably relate to state fiscal condition, which in turn relates to business cycles--not federal student aid policies.

As the "Fact Summary" indicates the pattern one would expect from behavioral analysis of how decisions are made corresponds closely to that reported by state officials. Strong federal inducements (e.g., participation in GSL and SSIG) have triggered the direct state responses sought by federal policy, but are not perceived as having a strong impact on state institutional funding or tuition decisions.

INFERENCES FROM AVAILABLE INFORMATION

A combination of the behavioral analysis and analytic approaches plus information gained from a partial literature review suggest conclusions about the probably impact of federal policy options likely to be considered by the Commission on state policy. These are discussed for each of the major federal proposals in this section.

Changes in Guaranteed Student Loans

From the perspective of federal officials worried over the budget, the subsidy component of the loan program is a substantial current outlay to be minimized. From a state perspective, however, true loans at a fairly high interest rate by historical standards are involved. These loans are not perceived as equivalent to grants by state officials, students or parents. This means that a loan is not really as good as low tuition in encouraging access. Perhaps more important, state officials are unlikely to be able to use the availability of loans in defending tuition increases to most students or their parents.

As a result, enhancing the loan program by such actions as removing the income cap, lowering the interest rate and/or establishing contingency forgiveness for certain public interest post-graduation employment would not seem likely to affect state policies regarding tuition significantly.

NGA does not have longitudinal data on the sources of support of public higher educational institutions by which one could analyze, by state, the percentage of total public higher education costs that are paid by tuition

and fees. Such information would be "best evidence" of the historical impact, if any, of federal student aid decisions. The little evidence we do have (Paul Brinkman, Higher Education Financing: 1978-1980 (NCHEMS), 1982, p.28) suggests that tuition as a percentage of the sum of tuition and fees and state appropriations has dropped from 23.0 percent in 1975 to 21.7 percent in 1980. These data would tend to support the conclusion that state appropriations and tuition decisions have not been driven in a high tuition direction by federal policies.

The GSL really performs two functions: (1) lowering the effective interest cost for those who borrow and (2) providing access to credit for some persons who would not get it otherwise at any price. If the federal government were to drop GSLs, some states would probably try to achieve the access objective and part of the subsidy objective with revenue-bond-financed state loans. Without direct (appropriated) state subsidy, such loans would have to have relatively steep interest rates to cover a loss reserve, administrative and borrowing costs. Interest while in school probably could not be forgiven, but some measure of access could be maintained by such a program. The federal outlay savings would be offset in part by increased federal tax expenditures associated with the additional use of tax exempt financing. Individual public institutions might also seek to fill a loan program gap caused by federal withdrawal from guaranteed loans.

A natural consequence of restrictions on the GSL program would be some fall-off in enrollments relative to what would be the case if the GSL program continued unchanged. This would be likely to exacerbate strains on

the higher education system resulting from enrollment fall-offs, but would be indistinguishable in effect from the other causes of fall-off. The fall-offs would probably affect the private sector disproportionately. High education interests can be expected to react to such fall-offs by seeking real increases in support per student which would be necessary to maintain current programs and personnel in the face of enrollment reductions.

The differential impact of GSL restrictions on various types of institutions will obviously depend upon what the restrictions are. However, restrictons such as requiring more student contributions as a basis for eligibility, lowering family income limits and eliminating eligibility for certain classes of students would appear likely to affect most adversely the higher cost institutions. These would be particularly the privates, but also the larger state institutions with graduate and professional programs.

Changes in Pell Grants

Pell Grants represent a major infusion of federal resources targeted to a reasonably small segment of the higher education student body, the students with the clearest financial need. They provide substantial assistance in enabling disadvantaged students to attend the higher quality state and private institutions, and allow these institutions to try to reach these students at a reasonable, though substantial, cost.

Pell Grants represent one of the strongest redistributive federal policies. Each grant moves a substantial amount of money to a highly targeted group of individuals. The education financed by the grant offers the prospect of allowing the student to have much more earning power than he or she would have without it.

There are a number of state scholarship programs which resemble Pell Grants in being based upon need and providing significant amounts of assistance per student. Some of these were in existence before Pell Grants and some came into existence after BEOGs (predecessors of Pell Grants). Comparative statistics on the state and federal programs in FY 1983 are shown below:

	Pell Grants	State Need Grants
Number of Awards (thousands)	2,500	1,253
Amount of Awards (millions)	2,419	976
Average Award	$968	$779

The National Association of State Scholarship and Grant Programs, the state officials administering scholarship programs, provides an annual survey that indicates the characteristics of the programs covered. Because there are multiple programs in some states, the survey covered 108 programs for the 1982-1983 academic year. Of these, 38 require applicants to apply to the Pell program also and 24 subtract the Pell Grant from the state determined need for assistance to generate a net need to be met by the state. Twelve programs do this without looking at the Pell Grant application. In roughly two-thirds of the programs, responsibilities for overawards are handled by the institutions.

The pattern of these state programs is very uneven. Some states have only the programs they need to take advantage of federal SSIG funding while other states substantially overmatch the federal funds. In the aggregate, the state programs are underfunded in the sense that substantial numbers of applicants are turned away for lack of funds.

The data suggest a diverse pattern of present practice and thus

reactions to changes in the Pell Grants that would vary by state and by institutions within states and with SSIG policy. Some states appear to be in the student assistance business at the state level only through the incentive of SSIG. In those states, elimination of SSIG would likely eliminate these programs in some states and at best reduce total grants by the amount of the federal component in others. These states would, of course, be the ones least likely to try to replace any losses from the Pell Grants.

In other states, the forces at work with a reduction in Pell Grants would be reasonably clear. Those favoring these programs would probably seek to achieve funding that would replace all of the Pell Grants, thereby maintaining the same student aid pattern as before. State resource allocators would probably be considering these requests along with other major requests to replace lost federal assistance in such major fields as mass transit operating costs and low income energy assistance. The result might be some increased allocation of state student assistance funds and a substantial redirection of existing state funding. That redirection would probably result in (1) lower total grants than the combination of Pell and state grants had been before for the most needy students, (2) more concentration of state funds on the most needy person and/or (3) some other rationing of the available grant funds.

The institutions themselves would also have to decide how to accept the impact of loss of Pell Grants on their own programs. Here the impact of federal retrenchment would probably cause some institutional filling of the resulting gap at the expense of the size of total awards to students with awards and a rationing of awards, presumably toward the most needy students.

Tuition Tax Credits

The purpose of tuition tax credit proposals would be to reduce the effective cost of higher education by allowing those paying a student's cost to reflect some of these costs in lower taxes. Proposals for the credit vary in terms of what costs would be recognized and how they would be recognized (e.g., partial credit or full) and what maximums would be involved.

Assuming that the credits would be related to the amount paid, they would tend to reduce the cost (in percentage terms) of attending high cost institutions more than low cost ones. Other things being equal (which they are not), this should benefit the privates more than the state residential institutions and the state residential institutions more than those institutions normally attended by persons who live at home. Overall, however, it should increase the consumption of higher education by making that consumption cheaper.

The impact on state spending and tuition policy would depend upon how the credits were structured. Theoretically, a credit or deductibility of some college costs would reduce the impact of higher tuition on voters and thus make it easier to raise tuition. In practice, state officials and voters may not consider deductibility or credits. For example, state income sales tax payments are deductible, but this fact is rarely discussed in the context of decisions on state tax increases.

Education Savings Accounts

The Administration's budget includes a proposal for education savings accounts. Parents could contribute $1,000 per child per year to these accounts with lesser contributions permitted for parents with adjusted gross income above $40,000. Unlike IRA's, the contribution would not be tax deductible but interest and dividends would not be included in adjusted gross income if eventually used to defray costs of tuition, room and board for the student.

If successful in generating substantial savings for higher education, the proposal would have a substantial effect in increasing the ability of parents to pay students' education costs. Other things being equal, it should mean less funding would be required in state and federal student aid programs. However, if reaction to this incentive is comparable to reaction to the much stronger incentive of the IRA, participation would be highest among the most affluent eligible persons. Those who were just barely meeting costs of food and lodging, children's clothing and other expenses would be the least likely to participate. Such a pattern would suggest that the same arguments that have persuaded state officials to hold down the share of education costs paid by students would continue to be influential in the future.

CONCLUSION

In the past, it would appear that state higher education financial policies have had little sensitivity to the characteristics of federal student assistance targeted at the needy potential student in the past. The causes of this low lack of sensitivity (e.g., tendencies by state decision makers to maintain a constant student share of instructional costs, rapidly changing and uncertain federal policy) are unlikely to change in the future, so the impact of these programs on major state financing decisions should continue to be slight.

Federal policies have had an impact on state student aid programs. By taking responsibility for millions of needy students, the federal government has reduced pressure on states to handle such students with grant programs of their own or through allocations of the resources of individual state higher educational institutions. The federal government incentives for states to begin student aid programs through the SSIG program have had some marginal infuence on state spending. These are portrayed in detail in a paper prepared by Jane Hansen of the College Board staff entitled "Summary of College Board Studies on the SSIG Program."

In FY 1981, the last year for which Census data is available, state higher educational institutions (excluding auxilliary enterprises such as student housing) spent $27.6 billion on higher education. In the same year, the federal government spent $6.8 billion on higher education. The federal total excludes substantial research purchased from higher educational institutions and includes funds spent outside higher education (e.g., for

student expenses other than tuition and fees). Of the state spending, approximately $6.1 billion was financed by tuition and fees suggesting that tuition and fees finance about 22 percent of state higher education spending. These numbers suggest that the federal impact on higher education has been substantial, with as much money involved as all tuition payments by all students.

It would be ridiculous to suggest that spending of this magnitude has had no impact on state higher education policies, unquestionably it has had. However, the impacts of state and federal financing have been quite different. States spend practically all their money subsidizing higher education providers, the public institutions, so they can provide their product at low costs to all students. The federal government spent practically all of its money subsidizing consumers by providing a large share of education costs to a targeted group of low income students.

The two sets of policies overlap only in those cases where the federal government subsidizes providers, which it now does only to a limited degree and for very special reasons, and when the state governments subsidize consumers which states, with federal encouragement, now do, though much less than the federal government does.

Otherwise the two policies are basically complimentary. The federal government has been committed to providing substantial student assistance to students attending either private or public institutions. When a student chooses a public institution, both the student and the federal treasury benefit from the state-provided subsidy. Substantial federal support of needy students has also made it easier for states to pursue their policies.

State and institutional student assistance funds are used to provide even deeper subsidies to needy students by supplementing federal funds. They are also used to support some students who would not meet federal need criteria or could have such small assistance amounts that they might not be able to attend state or private institutions without state aid.

In broad terms, the major federal policy issue is whether to continue what has become an established federal role in student assistance. The obvious option is to pull back from this role by some device or devices that cut eligibility, require larger contributions from students and their parents or otherwise cut federal costs. If the federal government were to withdraw from current student assistance patterns, state governments (including the higher educational institutions) could be expected to attempt to fill the most obvious void by redirecting current student assistance funding. However, this would not solve the resulting problems as no amount of reshuffling of $1 billion (state student assistance) would fill gaps left by withdrawal of $6.8 billion of federal spending. Substantial federal cutbacks in student assistance would also put pressures on states to increase their student assistance funding, just as federal withdrawals from other areas have increased pressures for spending in them. However, patterns of state spending do not change easily.

Given the incremental tendencies of state resource allocation, it would not be realistic to expect state student aid funding to increase at a rate of over, say, 15 percent a year even in the best of times. At a time when employee wages are being frozen and other programs being cut back (the current situation), increases of this magnitude are extremely unlikely.

Even a 15 percent increase in a billion dollar base does not provide a lot of replacement for $6-7 billion in federal funds. In addition, it should be remembered that many persons involved in education programs have different ideas of educationally effective policies. In the triage that is an inevitable part of state resource allocation, strong claims are being made that success or failure of education of the disadvantaged is being determined between age 3 and grade 3. Widespread acceptance of this argument is likely to discourage state resource allocation to programs designed to draw disadvantaged students into higher educational institutions and encourage state officials to follow a pattern of concentrating resources on lower grades.

This report concludes that changes in federal student aid have had, and will have, little if any, effect on state policies on support of higher education and the apportionment of higher education costs between students and taxpayers. It also concludes that there has been some effect in the area of state scholarship programs, stimulated through the SSIG program; however, meeting a need through Pell Grants and GLS may have caused added state allocations (in some states) in the absence of a federal program.

These conclusions suggest one other. Federal student aid spending of the magnitudes involved should have had more major effects somewhere in higher education other than the effects on states described above. It would appear that those effects were largely felt where federal policy-makers intended that they be felt: (1) in the access of needy students to higher education and (2) in helping to maintain the viability of private higher educational institutions and encouraging them to maintain a mix that included significant numbers of needy students.

While it is true that federal withdrawal from, or substantial restriction of, current patterns of student assistance would have a significant effect throughout higher education, it would seem that the effects would be concentrated primarily upon disadvantaged students and private institutions. Obviously federal cutbacks adversely affecting either of these groups would create pressures for state action. These pressures could in turn create some compensating actions, constrained by state fiscal conditions, decision makers' commitments to hold down state taxes and pressures from other quarters. However, experience with other federal policy changes, the aversion of state officials to adopting large numbers of means-tested entitlement programs and the nature of the state resources allocation process all suggest that states might do their best to mitigate damages to private institutions and the disadvantaged but would not avoid major damages vis-a-vis the expectations created by current policies.

These observations on the downside of federal policy change--restrictions, cutbacks, reduced funding--also apply on the upside. Federal officials can, from past history, have some considerable confidence that the state officials will not negate the thrust of expanded student assistance by sharply altered state behavior. The state track record is that tuition's share of public institutional costs has not gone up, even though many experts believe that it should, and that state scholarship programs have expanded alongside federal efforts.

STUDENT AID IN STATE MESSAGES AND BUDGETS

This section is part of the work done by the research staff of the National Governors' Association (NGA) for the National Commission on Student Financial Assistance. It was suggested by NGA on the grounds that interactions of state higher education policy and federal student assistance could not be adequately understood without reference to state budgets and governors' messages--the policy documents common to all states.

Documentation of Policy Decision-Making Processes in State Governments. Compared to the federal government, it is very difficult to understand the motivations underlying policies in a state. In the federal government, the positions of interest groups are normally formally documented in printed documents, such as published transcripts of hearings. In state governments this is not true. Hearings are often not recorded and transcripts are practically never published. In the federal government, staff work is normally made available to the public. Sponsored research is published and adequately catalogued. The work of staff agencies--such as the Office of Management and Budget, General Accounting Office and Congressional Budget Office--is often published. The general press and specialized newsletters follow positions of the players as policy is made.

The normal processes of state government do not produce this degree of documentation and, when documentation exists, it is no easy feat to collect if from 50 states. There are very few uniform policy-oriented documents among states. Of these, some important ones are state budgets, state-of-the-state, inaugural and budget messages of the governors and

enacted legislation (which has little relevance to federal student aid policy because in any given year there is little legislation enacted on student aid other than appropriations bills).

Methodology. This report is based upon a review of the governors' inaugural messages in the many states which had inaugurations this year, state-of-the-state messages, budget messages and actual state budget documents. In total, 45 states are covered. Those not covered are primarily states where the legislative session does not begin until April and one state (Kentucky) which will not be acting on either budgets or legislation this year. Each of the messages and/or the budget documents (normally all the messages and the budget documents) were examined to determine the treatment of higher education. While the recommendations of the governors do not control the decisions of the legislature, the govenors' recommendatons are a reasonably accurate proxy for ultimate legislative action as both the governors' and the legislatures tend to respond to the same economic and political forces in each of the states.

Relative Emphasis on Student Aid. Higher education was clearly not high on the agendas of the governors this year, as measured by the attention paid to it in major messages. The current economic situation and its effects on state revenues preoccupied most of the governors. Policy initiatives tended to fall into three fields: (1) economic development, (2) crime and (3) elementary and secondary education.

Higher education tended to be discussed in the messages primarily in terms of the contributions it could make to improving elementary and secondary education and economic development. For elementary and secondary education, the contributions of higher education most often cited were improved teacher preparation, retraining of teachers in science and mathematics and increased requirements for admission, particularly in math and science. For economic development, the contributions higher education could make were such things as improved technical assistance to business, research in high tech areas (plus agriculture or acquaculture in a few states) and generally maintaining programs that would attract new high tech employment.

With these emphases, it is not surprising that student assistance in higher education was mentioned in a few of the messages. When it was mentioned, it was most likely to be mentioned in connection with programs to improve the teaching of math and science in elementary and secondary schools through the provision of student loans with forgiveness for teaching in that field or grants to enable elementary and secondary teachers to improve their capabilities in these fields.

Spending Recommendations for Student Aid. The typical governor's budget message covers every major item of state expenditure. Thus state student assistance was mentioned in many of the budget messages. However, this mention was typically in the context of some decision-rule being applied to higher education as a whole.

The decision-rules most often applied were ones that were consistent with decision-rules being applied throughout the state's budget, not just to higher education or student aid. The decision-rules varied primarily with the fiscal position of the state. The most frequently encountered decision-rules were variants on attempting to maintain existing programs. Examples (in order of increasing funding) are:

(1) Maintain the absolute dollar level spending of the prior year;

(2) Maintain the program level of the prior year with adjustments for changing demand for loans and grants;

(3) Increase by some uniform percentage (3-5 percent normally) and

(4) Maintain the program level of the prior year with adjustments for demand and price levels (particularly tuition).

In several states, governors recommended that their current medical scholarship programs be converted to loans because the unmet demands of medical personnal are not so pressing as they once were.

There were a few exceptions to the general patterns described above. The Governor of South Dakota indicated dissatisfaction with the distribution of affordibility of higher education (poor get aid, rich can afford it, middle level groups fall through the cracks) and indicated he would be submitting legislation for a new student loan program. The Alaska Governor referred to a "college loan program that's nearly grown out of control." The budget document shows the program growing rapidly, but contains no proposals to limit growth. Alaska, with substantial oil revenues, provides up to $6,000 a year per student ($7,000 for graduate study) for student

loans for Alaska students attending school in or out of the state. Much of the loans are forgiven if the students return to Alaska.

Iowa's Governor focused on "the gap between tuition costs of our private colleges and universities and the Regents (state) universities." He judged the adequacy of the state tuition grant program by the degree to which it closed that gap and proposed that the maximum tuition grant award be increased. As a result he expected the grant to shift from closing 57 percent of the "gap" in FY 1983 to 64 percent of the "gap" in FY 1985.

Impact of Federal Policies on State Policies. In the messages and budgets of the 45 states studied there were no predictions of future federal student aid policy, no descriptions of those policies and no explicit ties between the policy recommendations and federal policy. There was one reference to federal policy changes having affected past state policies, though only small amounts are involved. On page I-370 of the four inches of Wisconsin's budget, the following appears:

> The Board requests $9,774,000 GPR (presumably general fund) ... in 1983-84 and in 1984-85 to restore GPR base funding for the grant program. GPR base funding was eliminated in 1982-83 because of significant increases in federal special allowance revenue. Projections for the 1983-85 biennium indicate sufficient special allowances are no longer available to fund WHEG (Wisconsin Higher Education Grants). The program provides average grant awards of $320 to an estimated 31,800 students annually.

Potentially Relevant Data. The Illinois budget provides some data on sources of student aid that are generally not provided in state budgets. According to the budget, FY 1982 financial aid (including loans) in Illinois (public and private) was divided among sources as follows:

State	20.8 percent
Federal	19.3
Other*	38.7
Institutional	21.1

* Includes guaranteed loans.

The state provided roughly twice as much of its assistance to students in public institutions as private. The federal assistance (excluding loans) provided slightly more financing for public than private education. Institutional support was concentrated in the private sector. Slightly more "other" assistance was provided to the public sector than to the private.

The Illinois budget also indicates trends in financial assistance. In FY 1982 the "average financial aid received per student attending Illinois institutions" was $3,131 in private institutions, $1,962 in public universities, and $449 in the community colleges.

Implications of this Review. This review totally supports the finding in NGA's major report to the National Commission on Student Financial Assistance that federal student aid policies appear to have no impact on state institutional support programs and tuition policy. Somewhat less support is provided for the conclusion that federal programs (particularly SSIG) had had an impact on state student aid grant policies. However, the findings are not inconsistent. With SSIG policy perceived as either stable or unpredictible, no change in state policy would, in the FY 1984 budgets, be associated with a change in federal policy. This is not inconsistent with a finding that the initiation of SSIG or its terminations would change state policy.

STATE TAX TREATMENT OF EDUCATION COSTS

This section is part of the work done by the research staff of the National Governors' Association (NGA) for the National Commission on Student Financial Assistance. It was suggested by NGA on the grounds that the full range of state policies affecting student assistance could not be understood without understanding state tax expenditures as well as state direct expenditures on student assistance and institutional support.

The Concept of Tax Expenditure. Analyses of the federal budget have long recognized that the federal government can provide nearly identical subsidies to particular activities through either the spending system or the tax system. The concept is now so widely recognized that the President's budget includes a compilation of tax expenditures and the Congressional Budget Office does an annual analysis of them. The concept is less widely recognized at the state level in terms of compilations, but there is a wide variety of tax expenditures to be found in state personal income taxes.

Methodology. The methodology for this paper was quite simple. State income tax forms for 1982 income (typically the returns due on April 15, 1983) were collected along with instruction booklets and explanatory material and supplemental forms for each state with a personal income tax. These materials were then reviewed and all special credits, deductions and exemptions related to the educational status of the taxpayer and/or taxpayer's dependents were extracted. The resulting state-by-state listing appears as Appendix A.

Federal Tax Treatment of Educational Expenses. Because state income tax forms and concepts of taxable income and deductions are typically molded on the federal system, understanding federal tax treatment of education is essential to understanding state tax treatment of the same subject.

Federal law allows as a deduction certain expenses of earning income, such as special tools and union dues. Education is treated as a candidate for one of these deductions. Thus, the test for deductibility of education is whether it is necessary in order for the taxpayer to maintain his or her current employment. A typical education deduction is expenses of a teacher who must take a few courses or lose certification. Generally, education for a change or upgrading of employment (e.g., a teacher going to law school) is not deductible. Education costs associated with non-employed full-time students are normally not deductible. Thus, with exceptions, education costs are treated like other consumption expenditures.

Federal law does recognize contributions, such as contributions to churches or colleges, as deductible from gross income in figuring the income subject to tax. The value of deductibility varies with the situation of the taxpayer. Those who do not itemize (typically lower income taxpayers who are not homeowners) get no advantage from deductibility of charitable contibutions with a minor exception enacted in 1982. For those who itemize the value of the deduction depends upon the marginal rate (bracket) of the taxpayer. For example, a deduction of $1000 is worth $50 for someone in the top (50 percent) bracket; $25 for someone in the 25 percent bracket, etc.

Tax credits differ from deductions in that the reduction in tax is identical regardless of the taxpayer's tax bracket. There are no federal tax credits for education.

State Patterns. Most states with income taxes follow the federal practice on treatment of educational expenses without exception. However, some states have made special provisions for higher educational costs.

State Tax Credits. Credits against income tax liability are provided in the state tax systems of Idaho, Indiana, Michigan and North Dakota. These credits are provided for donations to higher education institutions. In North Dakota, the credit is only for contributions to private colleges, but in the other three states it would appear to be available for contributions to private and public institutions. The credit also applies to public libraries and public broadcasting in Michigan and non-profit private high schools in North Dakota. Typically, the credit is available only for contributions to institutions in the state offering it. The terms of the credit provisions are shown below:

	Percent Donation	Ceiling	Max. Ind./Joint
Idaho	50	20 percent	$50/100
Indiana	50	100	100/200
Michigan	50	20	100/200
North Dakota	50	40	250/250

Vermont has no special provision for parents but allows the student to claim a credit of $10 on the student's return.

Personal Exemptions. In New Jersey a dependent under age 22 attending college full time results in an additional exemption to be added to the number of dependent exemptions. Each of these exemptions offsets $1,000 in adjusted gross income in calculating taxable income. The same exemption (also $1,000) is applicable in New York, but only for students attending educational institutions in New York.

Deductions. North Carolina taxpayers get a deduction of $660 for each dependent who is a full time higher education student.

In New Mexico a special deduction is provided for persons who (a) do not itemize on their federal return and (b) contribute to the "New Mexico Education Assistance Foundation."

Special Education Fund. New York allows taxpayers to contribute up to $750 per year per dependent to a special education fund similar to an IRA. Subsequent interest and dividends kept in the fund are not taxable. The fund is to be used to meet higher education expenses.

APPENDIX A

EDUCATION TAX EXPENDITURES OF INDIVIDUAL STATES

This attachment identifies the operation of education tax expenditures in those states with tax returns for 1982 income indicating such tax expenditures.

Idaho: Idaho allows individual taxpayers a tax credit for contributions made to non-profit private and state higher educational institutions. The credit allowed is one-half of the contribution with a ceiling of 20 percent of the taxpayer's Idaho tax liability and a ceiling of $50 on individual and $100 on joint returns.

In conjunction with federal and state deductibility, this provision reduces the costs of donations considerably for higher income taxpayers. A married couple in the highest federal bracket making a contribution of $100 would receive in tax advantages:

Federal Income Tax	$50.00
Idaho Income Tax	
Deductibility (approx.)	3.75
Credit	50.00
TOTAL TAX SAVINGS	103.75
Total Contribution	100.00
After Tax Cost of Contribution	-3.75

Incentives for lower bracket taxpayers would be considerably lower because the charitable deduction is lower for these taxpayers. Non-itemizing taxpayers would still benefit from the credit but not from deductibility from either state or federal taxes.

Indiana. There is a similar credit program in Indiana. The maximum credit is double that of Idaho's ($100 for individual, $200 on joint returns) and the credit is 50 percent of contributions. The credit cannot exceed tax owed.

Michigan. Michigan's tax expenditure includes libraries and public broadcasting as well as Michigan colleges and universities. The ceilings are 50 percent of the donation, $100 on individual returns ($200 joint) and 20 percent of tax liability.

An interesting contrast is provided by Minnesota which allows deduction of tuition, transportation and non-religious textbook expense. However, this deduction is available only for education through the 12th grade. The deduction is limited to $500 for dependents through the sixth grade and $700 in grades 7-12.

New Jersey. The New Jersey approach is to provide extra tax benefits to persons with dependents under age 22 attending college full time. In addition to being counted as a regular dependent the dependent is counted again (like the federal double exemption for blindness) for the exemption amount of $1000.

New Mexico. New Mexico confines its provision of a special deduction to people who do not itemize on their federal returns. Contributions to something called the New Mexico Education Assistance Foundation are deductible in calculating New Mexico taxable income.

New York. New York has two tax expenditures to reduce the after-tax cost of higher education.

Taxpayers are permitted to deduct $1000 per dependent attending a higher educational institution within the state.

New York also has something called PASS Fund Deductions. A parent may invest in a separate account up to $750 per child per year to defray later higher education expenses. The amount contributed each year is subtracted from income, just as contributions to an IRA are adjusted out of income in federal returns. In addition, the interest and dividends on funds in the account are not tax deductible. There are provisions for tax recapture if the funds are not used for higher education.

North Carolina. In North Carolina, taxpayers can take a deduction of $660 for each dependent who is a full time higher education student.

North Dakota. North Dakota provides its tax credits for donations to non-profit high schools and non-profit private colleges in North Dakota. The credit is for 50 percent of the contribution with maximums of $250 and 40 percent of the tax liability.

Vermont. A full time student filing a return in Vermont can claim a credit of $10, but no more than tax owed. This credit is only available on the student's return, not the parent's return.

APPENDIX B

SURVEY OF GOVERNORS' LIAISONS FOR HIGHER EDUCATION

FEBRUARY, 1983

INTRODUCTION

Sondra Nelson or Harold Hovey with the National Governors' Association will be telephoning the Governor's Liaison for Higher Education in the very near future. The National Commission on Student Financial Assistance has asked NGA to draw on the experiences and views of the higher education liaison in order to help them make recommendations to the Congress on the future structure of federal state financial aid.

We are particularly interested in the relation of the federal student aid program to your own state's policies for higher education.

1. From your experience, would you say that the various federal student aid programs caused your state to spend more, less or about the same as it would have otherwise for student aid?

   _____More _____Less _____About Same _____Don't Know

2. Are there any reasons for this?

   _____

   _____

   _____

3. What about the form of your student aid programs? Have the federal student aid programs caused your state to emphasize grants or loans or any other particular form of student assistance?

   _____Grants _____Loans _____No Effect _____Don't Know

   Other _____

   _____

4. Are there any reasons for this?

   _____

   _____

   _____

SURVEY/2

5. Regarding institutional support in contrast to student aid: what impact has federal student aid programs had on your state expenditures in relationship to institutional support for higher education?

_____More _____Less _____About Same _____Don't Know

6. Regarding private education, what impact have the federal student aid programs had on your state expeditures in relationship to institutional aid and aid to students enrolled in independent colleges and universities?

_____More _____Less _____About Same _____Don't Know

7. With regard to tuition tax credits for private colleges and universities, how have the federal student aid programs affected authorization of tuition tax credits in your state?

_____Encouraged _____Discouraged _____No Effect _____Don't Know

8. In relation to two-year institutions, has the federal student aid program either encouraged or discouraged state support for two-year institutions rather than four-year institutions in your state?

_____Encouraged _____Discouraged _____No Effect _____Don't Know

9. Do you think the federal student aid programs have either encouraged or discouraged the formation of two-year institutions in your state?

_____Encouraged _____Discouraged _____No Effect _____Don't Know

10. What other effects would you say the various student financial aid programs have had on your state's policies?

_____

_____

_____

Survey/3

11. What is happening in this legislative session on student financial assistance and higher education institutional support? Are there any proposals to substantially increase or decrease either student financial assistance or institutional support?

_____Yes _____No _____Don't Know

(If yes, specify) _____

_____

_____

12. Did the Governor submit a legislative package on student financial assistance and higher education institutional support and/or lend his support to a legislative initiative?

(If Yes, specify) _____

_____

_____

_____

These next few questions will seek your judgment about what would happen in your state if the federal student aid structure were changed.

13. If the size of the federal appropriation remained the same, but the matching requirements for the states were raised substantially, would your state be most likely to increase its support for student financial assistance, decrease it, or leave it about the same?

_____Increase _____Decrease _____Leave Same _____ Don't Know

14. If the size of the federal appropriation were reduced, but the matching requirement remained the same, would your state be most likely to increase its support for student financial assistance, decrease it, or leave it about the same?

_____Increase _____Decrease _____Leave Same _____ Don't Know

Survey/4

15. What if the federal government required the states to share the cost of all its grants and loans to students? Would the response in your state most likely be to increase state support for student financial assistance, decrease it, or leave it about the same?

_____Increase _____Decrease _____Leave Same _____ Don't Know

16. What changes in federal policy on student financial assistance would most likely cause your state to spend more on student aid?

_____

_____

_____

_____

17. If your state were to increase support for student aid, would this mean a reduction in funding for other higher education programs in your state?

_____Yes _____No _____Leave Same _____Don't Know

18. Are there any other suggestions you would like to make about the federal policy on student aid?

_____

_____

_____

Thank you for your time and cooperation.